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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Implementation of the Local	)	CC Docket No. 96-98
Competition Provisions of the	)	
Telecommunications Act of 1996	)	
	)	
Interconnection between Local	)	CC Docket No. 95-185
Exchange Carriers and Commercial	)	
Mobile Radio Service Providers	)	

PACIFIC TELESIS GROUP'S OPPOSITION TO PETITIONS FOR RECONSIDERATION

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SUMMARY

The Commission's First Interconnection Order established a comprehensive, detailed federal policy framework for promoting local competition. Many elements of that framework are consistent with initiatives already taken by the California Public Utilities Commission ("CPUC"), which has aggressively sought to open all telecommunications markets to competition. In other respects, however, Pacific Telesis Group ("PTG") believes that the Commission's new rules impede economically efficient competition, injure universal service, and usurp authority that Congress intended to reserve to the states. For these reasons, PTG has felt compelled to join in appeals of the First Interconnection Order.

The fact that PTG is a petitioner before the Eighth Circuit in no way diminishes its longstanding commitment to local competition. PTG will continue to comply fully with governing regulations and to negotiate interconnection agreements in good faith. Indeed, Pacific Bell has voluntarily negotiated agreements with eleven competitive local carriers ("CLCs") and will implement agreements with AT&T, MCI, and Sprint as soon as the CPUC concludes its arbitration proceedings.

Several CLCs have sought reconsideration of the First Interconnection Order. In general, these parties ask the Commission to exercise greater control over pricing matters, further reduce the rates charged for unbundled network elements and resold services, mandate additional unbundling, and set stricter limits on the ability of incumbent LECs ("ILECs") to respond to competition. PTG opposes each of these requests.

As an initial matter, the Eighth Circuit's Stay Order casts serious doubt on the merits of any plea for a more prominent federal role in implementing Sections 251 and 252 of the Communications Act. Although the stay's effect is most direct with respect to requests for more exhaustive national pricing rules, its impact is not limited to pricing matters. Rather, the court has strongly signalled its belief that the Commission, unless specifically instructed by Section 251 to adopt rules in a particular area, remains constrained by the enduring jurisdictional division contained in Section 2(b).

Even absent the stay, the relief sought by the CLC petitioners would be contrary to the law, facts, and sound policy. With respect to pricing matters, the petitioners urge a variety of "clarifications" and modifications aimed at achieving a single underlying goal: forcing ILECs to underwrite competitive entry, without regard for the detrimental impact on network investment and affordable local telephone service. With respect to unbundling, these parties press for extreme disaggregation of ILEC networks, without regard for the deleterious effect on network reliability and service quality. And, with respect to other terms and conditions of service, the CLCs seek to deny ILECs the ability to respond to competition, without regard for the damaging consequences for consumers.

The pendency of the stay obviously places these petitions in a peculiar procedural posture. To a large extent, the CLCs seek changes to rules that are in limbo pending a decision on the merits. Accordingly, one reasonable course of action might be simply to defer action on the petitions until the Eighth Circuit has ruled. PTG nonetheless does not believe such delay is necessary. As fully detailed herein, none of the CLC's requests has merit, and all should promptly be denied.

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OPPOSITION TO PETITIONS FOR RECONSIDERATION

Pacific Telesis Group ("PTG")[1] hereby submits its Opposition to the Petitions for Reconsideration of the Commission's First Report and Order ("First Interconnection Order") implementing the local competition provisions of the Telecommunications Act of 1996 ("the Act").[2] As PTG demonstrates herein, the petitions filed by competitive local exchange carriers ("CLCs") asking for even lower rates for unbundled network elements and resold services, more onerous unbundling requirements, and greater limitations on the business initiative of incumbent LECs ("ILECs") than already provided in the First Interconnection Order have no legal, factual, or policy basis.

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[1] PTG provides telephone service in California and Nevada through its wholly-owned subsidiaries, Pacific Bell and Nevada Bell, and offers a diversified range of other telecommunications and information services through other affiliates.

[2] In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325 (rel. Aug. 8, 1996)("First Interconnection Order"). Oppositions to the petitions for reconsideration are due October 31, 1996. See Petitions for Reconsideration and Clarification of Action in Rulemaking Proceedings, 61 Fed. Reg. 53922, 53923 (1996).

I. INTRODUCTION

The First Interconnection Order establishes rules and policies to implement Sections 251 and 252 of the Communications Act. In many cases, PTG believes that those rules and policies do not properly reflect Congress's desire to establish a deregulatory framework shaped largely by private negotiations and state oversight. Because of this fundamental disagreement -- and because PTG is concerned that the First Interconnection Order will impede its ability to continue providing affordable, high quality service to consumers in California -- PTG has joined numerous ILECs and state commissions in appealing that order. The Eighth Circuit is hearing the appeal on an expedited basis. Because many of the issues raised by the petitioners will be addressed, if not mooted, by the Court of Appeals, PTG urges the Commission, at a minimum, to take no action until the appeal has been decided. However, PTG believes because none of the CLCs requests have merit, the Commission can promptly deny them based on the record.

At the same time, however, PTG fully shares the Commission's goal of creating the opportunity for effective, economically efficient local competition. Indeed, PTG has significant incentives to promote local competition because the opportunity for competition is a necessary pre-condition to its entry into the long distance market.[3] PTG's commitment to competition is evidenced by the fact that its subsidiary, Pacific Bell, thus far has negotiated fourteen voluntary interconnection agreements with eleven

[3] 47 U.S.C. § 271(c).

CLCs, and eleven of those agreements already have been approved by the CPUC.[4] In addition, the CPUC will conclude its arbitration of agreements between Pacific Bell and AT&T and MCI before the end of the year. State-specific local competition rules are expected to be in place in the first quarter of 1997.

In late September, several CLCs filed Petitions for Reconsideration of the First Interconnection Order, even though that decision already is highly favorable to new entrants. These petitioners seek to extend and expand the new Part 51 rules in a number of unwarranted ways. For example, they demand even lower rates for interconnection and unbundled elements and greater discounts for resold services; urge the Commission to require even greater unbundling of the ILECs' networks; and request even greater limitations on the ILECs' ability to undertake legitimate business initiatives.

After these petitions were filed, the Eighth Circuit Court of Appeals stayed the pricing provisions and the "pick-and-choose" rule of the First Interconnection Order pending a decision on the merits.[5] Notably, the Court explained that opponents of federal pricing rules "have demonstrated that they will likely succeed on the merits of their appeals based on their argument that, under the Act, the FCC is without

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[4] Nevada Bell has received two requests for interconnection. It is also preparing a Statement of Generally Available Terms for filing pursuant to 47 U.S.C. § 252(f).

[5] Iowa Utilities Board v. F.C.C., No. 96-3321, (8th Cir. Oct. 15, 1996) ("Stay Order"). The "pick and choose" rule broadly interpreted Section 252(i) of the Act to permit an interconnecting party to choose any rate, term, or condition in an approved interconnection agreement.

jurisdiction to establish pricing regulations regarding intrastate telephone service ...."[6] The court was particularly critical of the Commission's proxies, explaining that they "will derail current efforts to negotiate and arbitrate agreements" and "would result in many incumbent LECs suffering economic losses beyond those inherent in the transition from a monopolistic market to a competitive one."[7]

Even without the stay, the CLCs' requests for reconsideration would have merited summary denial. Their recommendations would exacerbate the potential for uneconomic competition, further undermine the ILECs' ability to earn compensatory returns, confer on "new" entrants like AT&T and MCI additional unjustified competitive advantages, and virtually eliminate the states' authority over intrastate communications. Given the finding of the court, the Commission should not exert greater federal control over local interconnection and grant additional privileges to new entrants at the ILECs' expense. Consequently, each of the requests for reconsideration discussed herein should be denied.

II. THE CLCS' REQUESTS FOR RECONSIDERATION AND CLARIFICATION OF THE PRICING RULES ARE CONTRARY TO THE ACT AND SOUND PUBLIC POLICY.

The First Interconnection Order establishes national pricing methodologies for interconnection, unbundled network elements, reciprocal compensation, and resale. In addition, it prescribes interim proxies that states are compelled to use if they are unable

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[6] Stay Order at 16.

[7] Id. at 17, 18.

to approve cost studies that comply with the Commission's interpretation of the Act's pricing requirements. As explained above, the Court of Appeals has stayed application of the Commission's pricing rules because (1) the Commission appears to have overstepped its authority and (2) those rules may create an unconstitutional taking of property without compensation.

The CLCs have requested several modifications of the pricing rules, including:

- Endorsement of the Hatfield model as a means of determining costs of unbundled network elements;[8]
- Capping non-recurring costs ("NRCs") for unbundled network elements at the lowest of any NRC for an analogous retail service or any NRC charged by another ILEC for the same unbundled element;[9]
- Recovery of NRCs associated with network changes needed to comply with the First Interconnection Order from all carriers -- not just requesting CLCs -- on a "competitively neutral" basis;[10]
- Establishment of a presumption that the forward-looking cost of any change accomplished through software or electronic means is five dollars;[11]
- Recovery of costs associated with operations support systems (OSS) access through the prices for the unbundled elements to which the OSS

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[8] MCI Telecommunications Corporation's Petition for Reconsideration, CC Docket No. 96-98, at 2-7 (filed Sept. 30, 1996)("MCI Petition").

[9] Petition for Clarification and Reconsideration by the Association of Local Telecommunications Services, CC Docket No. 96-98, at 5 (filed Sept. 30, 1996)("ALTS Petition").

[10] Petition of AT&T Corp., CC Docket No. 96-98, at 11-15 (filed Sept. 30, 1996)("AT&T Petition").

[11] AT&T Petition at 18-20.

relates and clarification that the unbundled element price proxies already incorporate OSS-related costs;[12]

- Recovery of costs of higher-than-normal quality unbundled elements through "average incremental costs" or a rebate mechanism;[13]

- Prohibiting recovery of the costs of conditioning loops unless those costs would be necessary if the loop were provisioned using the most efficient available technology;[14]

- Establishment of a specific default wholesale discount for each ILEC based on an avoidable cost model supported by MCI;[15] and

- Exclusion of common costs and profit from rates for transport and termination.[16]

Each of these suggestions should be rejected. The requested rule changes would prevent ILECs from recovering legitimately incurred costs and force them to underwrite competition by new entrants. If the Commission is nonetheless unwilling to deny these requests, it must defer taking any action that would further impinge on the states' initiative until the Court of Appeals has made a final determination on the merits.

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[12] AT&T Petition at 28-29.

[13] MCI Petition at 31-35.

[14] Petition for Partial Reconsideration and Clarification of MFS Communications Company, Inc., CC Docket No. 96-98, at 6-7 (filed Sept. 30, 1996)("MFS Petition").

[15] MCI Petition at 12-15.

[16] Petition for Reconsideration of the National Cable Television Association, CC Docket No. 96-98, at 7-14 (filed Sept. 30, 1996)("NCTA Petition"); Petition for Reconsideration of Teleport Communications Group Inc., CC Docket No. 96-98, at 6-9 (filed Sept. 30, 1996)("TCG Petition").

A. The Hatfield Model systematically and egregiously understates ILEC costs.

In the First Interconnection Order, the Commission explicitly refused to adopt the Hatfield model as a means of determining the costs of unbundled network elements. In so doing, it stated that it "does not believe ... that the [Hatfield and Benchmark Cost Model] outputs by themselves necessarily represent accurate estimates of the absolute magnitude of loop costs." Id. at ¶ 794. It also acknowledged that the many criticisms leveled against the Hatfield (and BCM) models "may have merit." Id. at ¶ 795.

MCI now asks the Commission to endorse the Hatfield model, although it provides no basis for rebutting the criticisms recognized in the First Interconnection Order. Indeed, despite MCI's claims to the contrary, the latest version of the Hatfield Model perpetuates many of the fundamental flaws that make it an unrealistic means of determining costs and prices.[17] It is only a model, based largely on default values that bear no relation to any particular company's costs. Although users can define their own inputs, the Hatfield model results (as run by MCI and other CLCs) are based on entirely unrealistic default values for key "first order" variables, such as fill factors and equipment costs, and the model uses fictional expense ratios. It is not a cost study in any sense -- it is an amalgamation of algorithms designed to produce uneconomic subsidies for new entrants.[18]

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[17] MCI Petition at 2-7.

[18] The unreliability of this model is further demonstrated by the fact that it

(continued...)

Because the Hatfield model systematically underestimates ILECs' costs, using it to price unbundled elements would effectively deter facilities-based competition. In essence, the model would declare the ILEC's network a natural monopoly: by definition, under the Hatfield model, rates for unbundled elements would be set assuming use of the most efficient possible technology and vast economies of scale. As a result, no new entrant could ever hope to construct facilities more cheaply than a CLC could obtain those facilities from the ILEC, and the ILEC would have no incentive to improve, or even maintain, its network. Because the Hatfield model would not allow ILECs to recover their costs and would frustrate the introduction of facilities-based competition, the Commission should not authorize its use.[19]

B. <u>ILECs must be entitled to recover fully the non-recurring costs of implementing the First Interconnection Order and providing unbundled network elements</u>.

The <u>First Interconnection Order</u> clearly provides that ILECs are entitled to impose non-recurring charges to recover their non-recurring costs. Indeed, the Commission expressed a preference that non-recurring costs be recovered through non-recurring charges, stating that "[e]lement rates shall be structured consistently with the

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[18](...continued)
sometimes assigns end users to the wrong wire center and even to the wrong telephone company.

[19] The Hatfield model results for Pacific Bell contained in the July 3, 1996 ex parte presentation by AT&T and MCI show total company costs of only $3.428 billion. Pacific Bell's ARMIS reports filed with the Commission reveal total company costs exceeding $7 billion -- more than twice the fictitious figure produced by the Hatfield model.

manner in which the costs of providing the elements are incurred."[20] AT&T nonetheless requests that the Commission clarify that non-recurring costs incurred as a result of an ILEC modifying its network to serve new competitors should be recovered from all carriers -- not just requesting CLCs -- in a "competitively neutral" manner.[21] Similarly, ALTS seeks to cap non-recurring charges ILECs can impose to recover their provisioning costs.[22] The first plan is an effort to force LECs to pay for costs caused by their competitors while the second is an effort to arbitrarily ignore costs that are actually incurred. Neither request is warranted.

ILECs will incur significant implementation costs in unbundling their integrated networks and providing services for resale. For example, in 1996, Pacific Bell budgeted $30 million for implementation of unbundled network elements and $25 million for implementation of resale of services to comply with the Commission's Rules and expects to incur additional costs in 1997.[23] These costs are caused directly by new entrants. For example, PTG would not be required to expend resources to provide customized routing if no CLC wanted customized routing. Once such a request

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[20] 47 C.F.R. § 51.507(a). In addition, the Commission's Rules provide that "[s]tate commissions may, where reasonable, require incumbent LECs to recover nonrecurring costs through recurring charges over a reasonable period of time." Id. § 51.507(e).

[21] AT&T Petition at 11-15.

[22] ALTS Petition at 5.

[23] The estimates for 1996 do not include all costs, such as implementation of long-term number portability and universal service obligations.

is made, PTG must be entitled to recover the associated costs from the requesting party.

There is no basis in the statute for spreading the one-time costs of complying with the Act among all carriers, as AT&T proposes.[24] When Congress intended such a cost recovery mechanism, as with number portability, it expressly required that the relevant costs be "borne by all telecommunications carriers on a competitively neutral basis."[25] In contrast, the rates for unbundled network elements and interconnection are to be "based on cost . . . nondiscriminatory, and may include a reasonable profit,"[26] with no reference to costs being shared in any way. In fact, the legislative history makes clear that LECs are entitled to recover from interconnecting parties all costs associated with, for example, making available particular kinds of interconnection or specific unbundled elements. In this regard, the House Report on H.R.1555 (the House telecom reform bill) explained that questions of economic reasonableness should not be considered in determining technical feasibility because ILECs are entitled to recover all costs caused by the requesting party:

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[24] AT&T Petition at 14.

[25] 47 U.S.C § 251(e)(2). The Commission has interpreted this standard to effectively require that the incumbent LECs bear the vast majority of number portability implementation costs, and AT&T obviously is relying on this interpretation in advocating "competitively neutral" recovery of non-recurring implementation costs. Pacific Bell is seeking reconsideration of the Commission's <u>Number Portability Order</u>, including its interpretation of the "competitively neutral" standard.

[26] 47 U.S.C. § 252(d)(1).

> During the Committee's consideration of the bill, the Committee deleted a requirement that unbundling be done on an "economically reasonable basis" out of concern that this requirement could result in certain unbundled services, elements, features, functions, and capabilities not being made available. The Committee clarified, however ... that the beneficiary of unbundling must pay its cost.[27]

AT&T's request is a transparent effort to force ILECs to bear most of the costs associated with transitioning to competition; essentially, AT&T is asking that ILECs fund the entry of new competitors into the local market. Such inefficient competition will not benefit consumers. In its interconnection agreements, Pacific Bell has provided a means of recovering its implementation costs from the cost causers in a manner that avoids placing unreasonable burdens on any one CLC. For example, Section 4.1.6 of Pacific Bell's proposed interconnection contracts with AT&T, MCI, and Sprint allows the first ten users of an interconnection feature or unbundled element to share equally the costs of development by refunding a portion of the costs to each party that has already helped pay for that feature or element. This mechanism ensures against double recovery by the ILEC while promoting economically efficient competition. Accordingly, AT&T's proposed clarification should be denied.[28]

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27 H.R. Rep. No. 104-204, 104th Cong., 1st Sess. 71 (emphasis added).

28 Likewise, AT&T's proposal that the Commission establish a rebuttable presumption for TELRIC cost studies that the forward-looking cost of any non-recurring activity that can be accomplished through software or electronic means be $5 is completely without foundation and grossly underestimates the potential costs of implementation. Development of specialized software and electronic changes can be very expensive and a charge significantly larger than $5 will likely be necessary in some cases. For example, when a customer chooses to receive service from a reseller

(continued...)

Nor is there any basis for imposing arbitrary caps on NRCs associated with provisioning unbundled elements, as proposed by ALTS.[29] Specifically, ALTS proposes that: (1) non-recurring charges should be equal to or less than the lowest non-recurring charge for the most analogous LEC retail service and (2) non-recurring charges for unbundled elements should be capped by the lowest of any LEC's non-recurring charges for the same element unless a LEC can demonstrate why that rate is inapplicable. Neither proposal has any merit.

First, the work involved in provisioning unbundled elements for a CLC may not bear a close relationship to the work involved in providing service to end users, and it may be difficult to identify analogous retail services in any event. In addition, non-recurring charges for LEC retail basic services are often set below cost by state regulators to advance specific policies such as universal service. Further, different ILECs have markedly different network architectures, technologies, ordering and

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[28](...continued) instead of Pacific Bell, the costs incurred by Pacific Bell average more than $50 because Pacific Bell must: 1) issue a disconnect order and send a final bill to the end user; 2) issue an order against the CLC's primary billing account to establish the resale services (which requires different USOC codes); 3) then, depending on the resale services involved, move the services to the Carrier Access Billing System (CABS); 4) ensure that systems used to inventory and assign facilities are updated to reflect carrier changes; 5) verify and reassign office equipment to the CLC; and 6) manually update the Automatic Response Unit for the appropriate end user and CLC information. A $5 charge was found by the Commission to be reasonable for PIC changes, which are much less complex than many of the procedures that will be required for interconnection-related activities.

[29] ALTS Petition at 5.

provisioning systems, and economies of scale and scope. Consequently, the non-recurring costs (and hence, the charges) for provisioning unbundled elements are likely to vary significantly among ILECs. For example, unlike other LECs, Pacific Bell still has many older switches with limited capacity in use, such as 1AESS switches (which in some cases preclude customized routing because of limited line class codes) and DMS 100 switches (which have an absolute design limit of four 0- routes per DMS 100 end office switch). Pacific Bell will need to replace much of this equipment in order to meet the demands of interconnecting parties.[30] The Commission should therefore deny ALTS' requests.

C. Contrary to AT&T's claims, the proxies clearly do not incorporate operations support systems-related costs.

The First Interconnection Order establishes proxies for network elements, but does not define a charge or range of charges for access to operations support systems (OSS). Rather, for OSS and other network elements where the Rules do not specify a proxy charge, the Commission stated that "[i]n the absence of an acceptable forward-looking cost study, states may establish default proxy ceilings . . . by identifying the direct costs of providing the element and adding a reasonable allocation of joint and common costs."[31] AT&T requests that the Commission "clarify" that (1) the interim default proxy rates for other unbundled elements already reflect OSS costs and that no

[30] Pacific Bell also has different network technology which makes sub-loop unbundling infeasible. See Section III.A.

[31] First Interconnection Order at ¶ 827.

additional charges may be imposed and (2) recurring costs associated with OSS access should be built into the charges for the network element or elements that such systems support.[32] There is no basis for granting such relief.

As an initial matter, the proxy rules have been stayed in their entirety, rendering AT&T's request moot. Moreover, and in any event, nothing in the First Interconnection Order indicates that the proxies for other elements already include OSS costs. They plainly do not. The Commission's element-specific proxies are taken from pre-existing state determinations or individual cost studies of specific services. These studies could not include OSS access costs, because at the time they were performed, third parties generally did not have access to ILEC OSSs and ILECs thus had no reason or data to estimate such costs.

Nor, on a going-forward basis, should OSS access costs necessarily be rolled into the charges for other unbundled network elements. Doing so could uneconomically convert a direct cost, which can be recovered from cost causers in proportion to usage, into a shared cost of several elements, the recovery of which will be inherently arbitrary. For example, two CLCs may each use an ILEC OSS to order unbundled loops; one orders a single loop and the other orders one hundred loops. Each order could impose roughly the same costs on the ILEC in terms of OSS resources used, so cost recovery on a per-order basis (taking into account any material cost differences based on the type of order submitted) is efficient. By allocating a

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[32] AT&T Petition at 28-29.

portion of OSS access costs to loops, however, as AT&T requests, the carrier ordering one hundred loops would bear far more than its share of the costs imposed by its use of the ILEC OSS.

In its ongoing arbitration proceedings, Pacific Bell has proposed to track its costs of implementing and provisioning access to OSS and impose a recurring charge to recover those costs, with a true-up once the CPUC has approved a cost recovery mechanism. Because each ILEC is in a different phase of implementing access to its OSS, the Commission should leave recovery of these costs to the state commissions, which are in the best position to determine the most equitable recovery mechanism.

D. ILECs must fully recover the costs of providing higher-than-normal quality service.

The First Interconnection Order properly entitles ILECs to recover the costs associated with providing higher-than-normal quality service. For example, the Commission concluded that the Act requires the ILEC to provide a requesting carrier with superior interconnection than the ILEC provides for itself, "as long as new entrants compensate incumbent LECs for the economic cost of the higher quality interconnection ...."[33] Similarly, the Commission stated that compelling ILECs to provide requesting CLCs with access or with unbundled elements of higher-than-normal quality was not "unduly burdensome ... because the 1996 Act requires a requesting carrier to pay the costs of unbundling, and thus incumbent LECs will be fully

[33] First Interconnection Order at ¶ 225 (citation omitted).

compensated for any efforts they make to increase the quality of access or elements within their own network."[34]

Requests that ILECs spread such costs among all users, or even forego recovery of such costs to the extent existing plant is not the most efficient available,[35] would prevent full recovery of costs that are reasonably incurred in direct response to a CLC's request for a particular functionality or level of service. As the Commission noted, Congress intended that CLCs pay the costs engendered by providing them with interconnection, access, and unbundled elements, including the costs associated with higher quality service. The petitioners' proposals are therefore contrary to the Act and must be denied.

E. The resale default proxy range already is too high, and the Commission should not specify a default discount for each ILEC.

Section 252(d)(3) of the Communications Act provides that "a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." The First Interconnection Order and Section 51.609 of the Commission's Rules identify several USOA accounts that are presumed avoided, but permit the incumbent LEC to prove "to a state commission that specific costs in these

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[34] First Interconnection Order at ¶ 314.

[35] MFS Petition at 6-7.

accounts will be incurred and are not avoidable ... or that specific costs in these accounts are not included in the retail prices of resold services."[36] In addition, the Commission held that plant-specific expenses and plant non-specific expenses shall not be considered avoidable unless "a party proves to a state commission that specific costs in these accounts can reasonably be avoided when an incumbent LEC provides a telecommunications service for resale ...."[37]

The Commission also adopted a proxy range of 17-25 percent avoided costs, which states may use if they "cannot, based on the information available ... establish a wholesale rate" using the methodology discussed above.[38] If a state chooses a proxy percentage, it must apply the same discount to all resold services, articulate the basis for selecting that discount, and establish permanent wholesale rates on the basis of an avoidable cost study within a reasonable time thereafter.[39]

As noted above, the Eighth Circuit Court of Appeals has stayed the Commission's proxy rules, including the proxy range for the discount for resold services. This stay is based upon the court's preliminary conclusion that the Commission has seized control over pricing matters that the Act committed to the states and that the federal pricing rules would force ILECs to suffer unwarranted economic

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[36] 47 C.F.R. § 51.609(d).

[37] Id.

[38] Id. § 51.611(a).

[39] Id. § 51.611(b).

losses.[40] Against this background, MCI's request that the Commission mandate a default wholesale discount rate for each ILEC using MCI's model is clearly inappropriate.[41]

Moreover, MCI's request for deep wholesale discounts is entirely unjustified regardless of the stay. In arbitration hearings before the CPUC, Pacific Bell has demonstrated that even the low end of the wholesale discount proxy overstates Pacific Bell's avoidable costs. In the CPUC's OANAD proceeding, Pacific Bell has filed TSLRIC-based studies revealing avoided costs of 4.6 percent for business services and 14 percent for residential services. Even using the legally suspect avoidable cost methodology set forth in ¶ 917 of the Commission's First Interconnection Order, the maximum retail-related costs associated with Pacific Bell's current rates for flat-rate residential access service are 12.6 percent when including directory assistance ("DA") and 0- service, and 16.7 percent when excluding DA and 0- service.

In addition, MCI's model for determining avoided costs fails to comply with the Commission's methodology in several respects and rests on numerous erroneous assumptions:

- MCI incorrectly removes 100 percent of the costs of operator and directory assistance services from its calculations, even though many resellers will continue to use these ILEC services. Furthermore, Pacific

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[40] Stay Order at 17-18. PTG continues to believe that the Commission erred in basing the wholesale discount on avoidable, rather than avoided costs, and will pursue this issue before the Court of Appeals.

[41] MCI Petition at 13.

Bell has separate charges for operator and directory assistance services. The only costs avoided when a reseller provides its own directory assistance and operator services therefore are the free directory assistance calls included with the basic service.

- MCI overstates the avoided common corporate costs by allocating common corporate expenses by the ratio of avoided expenses to total expenses. In reality, common corporate costs are not avoided to nearly the same extent as direct expenses when a company exits the retail market.

- MCI improperly calculates the resale discount by transferring return on ILEC investments to CLCs. In its calculations, MCI determines the avoided cost discount percentage by dividing total avoided costs by total expenses excluding return and taxes. However, since the discount is applied to prices, the avoided costs should be divided by revenues, not expenses. By using total expenses in the denominator, the MCI discount inappropriately transfers to the reseller contributions to return and income taxes for loop, switch, and other investments provided by the ILEC and used by the reseller.

- MCI exaggerates avoided product management costs. The First Interconnection Order requires that avoidable costs must be determined by modeling the firm as "if it were to cease retail operations and instead provide all of its services through resellers."[42] Even if PTG were only to provide wholesale services, it would still incur wholesale product management costs; indeed, the vast majority of its current retail service product management expenses would be replaced by wholesale product management expenses with little or no reduction in Account 6611. MCI would incorrectly disallow these expenses, including those associated with development of the new products that MCI expects wholesalers to provide.

- MCI inflates avoided costs by ignoring sales resources and advertising expenses. Firms providing only wholesale services will continue to incur such expenses in substantial amount.

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[42] First Interconnection Order at ¶ 911.

Because of these significant inaccuracies and errors, MCI's model should not be used to calculate either proxy ranges or specific discounts for ILECs, even if the court concludes that the Commission has authority to establish national pricing rules.

Finally, MCI's request for specific ILEC discounts is a waste of the Commission's time and resources because many state commissions, including the CPUC, will have adopted either interim or long-term discounts by the time the Eighth Circuit issues its decision on the merits and reconsideration is completed. The Commission accordingly should refrain from setting ILEC-specific default proxies.[43]

F. The additional costs of transport and termination include a reasonable allocation of shared costs and a reasonable profit.

In the First Interconnection Order, the Commission determined that the costing standard for transport and termination should be identical to the standard for interconnection and unbundled network elements: TELRIC (including the cost of capital, which the Commission equates with a reasonable profit) plus a reasonable share of joint and common costs.[44] NCTA and TCG now request that the Commission reconsider its decision to include forward-looking common costs and profit within the transport and termination rate-setting standard and instead limit the price for transport

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[43] PTG also notes that specifying an interim wholesale proxy for each LEC would be tantamount to setting intrastate rates -- a task that counsel for the Commission, in oral argument to the Eighth Circuit, acknowledged is reserved to each state. See Iowa Utilities Board v. F.C.C., No. 96-3321, Record of Court Proceedings, at 24, 27 (8th Cir. Oct. 3, 1996).

[44] PTG does not endorse the TELRIC standard, and will present its views on the flaws of that standard to the Eighth Circuit.